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MR. S. MOORE, DEPUTY

**CALIFORNIA SUPERIOR COURT
COUNTY OF LOS ANGELES**

THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA,

Plaintiff,

vs.

ALL PERSONS INTERESTED IN THE
MATTER of the validity of the Fourth
Supplemental Resolution for Commercial Paper
and Revolving Notes, supplementing the security
of the Metropolitan Water District's Commercial
Paper with certain wheeling rates,

Defendants.

NO. BC164076

TENTATIVE DECISION

[Assigned by the Judicial Council to the
Honorable Laurence D. Kay, San Francisco
County Superior Court]

INTRODUCTION

Water Code Sections 1810 through 1814: The Wheeling Statutes

Water Code sections 1810 through 1814 (collectively hereinafter the "Wheeling Statutes") provide for the joint use of excess capacity in water conveyance facilities. These five sections, the relevant portions of which are discussed here, provide that an agency which owns a water conveyance facility with excess capacity may not deny use of the facility to an entity who wishes to transfer water through those facilities. Such transfer is called "wheeling." The Wheeling Statutes also govern how the agency is to go about setting compensation for wheeling transactions.

-1-

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Specifically, section 1810 provides that state, regional, and local public agencies may not deny bona fide water transferors the use of a water conveyance facility that has excess capacity, when such capacity is available, so long as fair compensation is paid for the use of the facility. Subsection (d) of that section provides that the use of a water conveyance facility is to be made without injuring any legal user of water. Section 1811 contains a series of definitions. At issue in the instant case are the legal meanings of "fair compensation," "replacement costs," "unused capacity," and "any legal user of water."

Section 1812 requires the agency owning the water conveyance facility to determine, in a timely manner, the amount and availability of unused capacity as well as the "terms and conditions, including operation and maintenance requirements and scheduling, quality requirements, term of use, priorities, and fair compensation." Section 1813 requires the respective public agency to act in a reasonable manner, consistent with the requirements of law, to facilitate water transfers when making the necessary determinations. It also provides that in any judicial action challenging any determination made by the facility owner, the court shall consider all relevant evidence and shall give due consideration to the purposes and policies of this article, and that a court reviewing an agency's determination shall sustain the agency's determination if it is supported by substantial evidence. Finally, section 1814 provides that this article applies only to 70 percent of the unused capacity.

"Fair compensation" means the reasonable charges incurred by the owner of the conveyance system, including capital, operation, maintenance, and replacement costs, increased costs from any necessitated purchase of supplemental power, and including reasonable credit for any offsetting benefits for the use of the conveyance system." Water Code § 1811(c).

"Replacement costs" mean the reasonable portion of costs associated with material acquisition for the correction of unrepairable wear or other deterioration of conveyance facility parts which has an anticipated life which is less than the conveyance facility repayment period and which costs are attributable to the proposed use." Water Code § 1811(d).

"Unused capacity" means space that is available within the operational limits of the conveyance system and which the owner is not using during the period for which the transfer is proposed and which space is sufficient to convey the quantity of water proposed to be transferred." Water Code § 1811(e).

"This use of a water conveyance facility is to be made without injuring any legal user of water and without unreasonably affecting fish, wildlife, or other instream beneficial uses and without unreasonably affecting the overall economy or the environment of the county from which the water is being transferred." Water Code § 1810(d).

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STATEMENT OF FACTS

Metropolitan Water District's Setting of Firm and Non-Firm Rates

The Metropolitan Water District (hereinafter, "MWD") is a major supplier of water to Southern California. It owns and operates hundreds of miles of pipes and aqueducts, as well as reservoirs and other facilities. It consists of 27 member agencies, primarily cities and municipal water districts. MWD's board of directors is made up of 51 members whose voting rights depend upon the taxes paid by the residents of each member agency.

In 1994, MWD began a process to develop uniform wheeling rates that it would charge to its members for the use of its water conveyance facilities. It developed two rates that it argues are necessary in order for it to receive fair compensation pursuant to the Wheeling Statutes. One rate is for non-interruptible use of MWD's facilities. Under this rate, MWD will guarantee a member space in its water transfer facilities; it will, in effect, create excess capacity and reserve that excess capacity for the member's use. The rate for this non-interruptible use of capacity is \$262 per acre foot of water. MWD's second rate is for interruptible service. Under the interruptible rate of \$141 per acre foot, MWD maintains the power to interrupt a water transfer taking place through its facilities for "any reason."

The non-interruptible rate includes most of MWD's system-wide costs, including most of MWD's costs for obtaining water from the State Water Project. Both rates include costs for incentive payments for local conservation, and water supply development programs, as well as charges for water distribution, including charges for pipelines, aqueducts, and transportation of State Water Project water. The non-interruptible rate also includes costs for storing water. Both rates are "postage stamp" rates; that is, they are fixed in advance of any particular proposed transaction. Thus, the rates are not determined according to the amount of water a member transfers through MWD's facilities, nor the distance the water is to be wheeled, nor what portion of MWD's facilities are to be used for a given water transfer. Rather, the rate is set at either \$262 or \$141 per acre foot, respectively, for "uninterruptible" and "interruptible" service.

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1 On January 14, 1997, the MWD board of directors adopted a "Resolution of the Board of
2 Directors of The Metropolitan Water District of Southern California Fixing and Adopting Wheeling
3 Rates," which set forth the two "postage stamp" wheeling rates described above. One MWD
4 member, San Diego County Water Authority (hereinafter "San Diego") objected to the rates and
5 voted against the resolution. Because the board's vote was 26 in favor to one opposed, the resolution
6 was adopted.

7
8 MWD pledged the revenue it expected to receive as a result of these wheeling rates as
9 security for certain commercial paper and revolving notes. MWD then brought this action, pursuant
10 to Code of Civil Procedure sections 860, et seq. seeking validation of its "Resolution of the Board of
11 Directors of the Metropolitan Water District of Southern California Further Amending and Restating
12 the Definition of Operating Revenues (Fourth Supplemental Resolution)," pledging the revenues that
13 it expected to receive as a result of the rates it set under Water Code sections 1810 through 1814.
14 The effect of validation of MWD's rates through this procedure, pursuant to Code of Civil Procedure
15 sections 860 through 870, would be to forever bar the public from contesting the validity of the rates
16 in a court of law. See Code of Civil Procedure §869 and §870.

17
18 By order dated August 15, 1997, this Court bifurcated this action. Phase I deals with two
19 purely legal issues. The first is whether MWD may include all of its system-wide costs in
20 calculating its wheeling rates, or instead only costs relating to particular facilities. The second is
21 whether MWD may set "postage stamp" wheeling rates, in advance and without regard to any
22 particular wheeling transaction. If necessary, the Court would review the dollar amounts of the rates
23 in Phase II.

24
25 The Phase I trial in this matter took place in Department 13 of the San Francisco Superior
26 Court on November 7, 1997. Brian S. Currey and Richard Beller appeared on behalf of plaintiff
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1 MWD; Scott S. Slater, Colin Pearco, Stephanie Osler, and James Taylor appeared on behalf of
2 defendant San Diego County Water Authority; David Osias, Mark Hattam, and Jeffrey Patterson
3 appeared on behalf of defendant Imperial Irrigation District; Mason Morisset appeared for defendant
4 Quechan Indian Tribe; Warren Felger appeared for defendant Cadiz Land Company; Michael
5 Duncheon appeared on behalf of defendant Inyo-Mono County Farm Bureau; Lester Marston and
6 Scott Johnson appeared for defendant Chemehuevi Indian Tribe; and Robert Fellmeth appeared for
7 defendant Center for Public Interest Law ("CPIL"). Barton Thompson was present on behalf of the
8 Environmental Defense Fund, which is not a party to this case, but which submitted a brief as an
9 *amicus curiae*. Western Water Company also submitted an *amicus curiae* brief.

DISCUSSION

Standard of Review

13 MWD urges the Court to review the rates under a deferential substantial evidence standard,
14 citing Water Code section 1813. That section provides that in "any judicial action challenging any
15 determination made under this article," the court "shall sustain the determination of the public
16 agency if it finds that the determination is supported by substantial evidence." MWD maintains that
17 the decisions of whether to apply a postage-stamp rate, and whether to include its system-wide costs
18 in that rate, are factual determinations it is required to make under the Wheeling Statutes. It
19 therefore reasons that its decision to charge postage-stamp wheeling rates that include system-wide
20 costs is subject to substantial evidence review by this Court.

21 However, as MWD appeared to concede during Phase I argument, what is at issue in this
22 phase is a legal question - interpretation of a statute - which is for the Court, *de novo*, and not an
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1 administrative agency.² See Simpson v. Unemployment Ins. Comp. Appeals Bd. (1986) 187
2 Cal.App.3d 342, 350. The issue presently at hand is not whether the terms and conditions for
3 wheeling transactions set by MWD are reasonable in the abstract, but whether MWD has set its
4 wheeling rates in a manner consistent with the requirements of the Wheeling Statutes.

5 I. System-Wide Costs vs. Particular Facilities

6 Fair Compensation

7 MWD's inclusion of costs unrelated to any given transfer, such as State Water Project supply
8 costs or conservation incentive program costs, violates the statutory definition of "fair
9 compensation." As noted, Water Code section 1810 provides that an agency that permits a water
10 transferor to use its facilities is to be paid fair compensation for the use of the facilities.³ The term
11 "fair compensation" as used in the Wheeling Statutes is defined in Water Code section 1811(c) as
12 follows:
13

14 "fair compensation" means the reasonable charges incurred by the owner of the
15 conveyance system, including capital, operation, maintenance, and replacement costs,
16 increased costs from any necessitated purchase of supplemental power, and including
17 reasonable credit for any offsetting benefits for the use of the conveyance system."

18 MWD contends the word "incurred" should be interpreted to mean *any* costs of the owner of
19 the entire conveyance system, other than the cost of water itself. Under such an interpretation,
20 MWD would be permitted to include, and indeed has included, such costs as its State Water Project
21 supply costs, conservation incentive payments and fixed portions of its other "capital" costs that are
22

23
24 ² R.T. November 7, 1997, p. 15.

25 ³ The first sentence of section 1810 provides: "Notwithstanding any other provision of law, neither the state,
26 nor any regional or local public agency may deny a bona fide transferor of water the use of a water conveyance facility
27 which has unused capacity, for the period of time for which that capacity is available, if fair compensation is paid for
28 that use, subject to [certain requirements]."

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1 not directly related to an individual wheeling transaction. Some of those costs are fixed costs MWD
2 must pay regardless of whether any wheeling transactions take place. Such an interpretation would
3 be inconsistent with the statutory purpose and language. The use of the modifier "incurred,"
4 embracing capital, operation, maintenance, and replacement costs, can only mean incremental costs
5 brought about by a particular wheeling transaction. Reading the statutes together, the Court is
6 compelled to conclude that the Legislature intended section 1811(c) to refer to any *additional*
7 capital, operation, or maintenance costs brought about by a specific water transfer. The Wheeling
8 Statutes exist in the first place to facilitate individual water transfer transactions and to provide that
9 the owner of the system be made whole for the incremental cost of the transfer. MWD argues that
10 the inclusion of system-wide capital and other costs unrelated to the specific transfer should be part
11 of fair compensation, for were it not for such system-wide operations, MWD would not be the
12 agency that is and would not be in a position to offer the service. While that position may not be
13 unreasonable, it is not in conformance with the limitations contained in the Wheeling Statutes.

16 As defendants point out, fair compensation is to be paid "for that use." Water Code section
17 1810. The phrase "for that use" refers to the use, by a bona fide transferor, of a water conveyance
18 facility that has unused capacity. The fair compensation definition cannot be read separately and
19 apart from the introductory sentence of section 1810, which requires the leasing of available space
20 and which requires fair compensation *for that use*.

21 MWD also contends that section 1812 leaves to MWD's discretion such questions as
22 whether, apart from replacement costs, it may include system-wide costs in its rates. In support of its
23 position, MWD points out that where the term "replacement costs" appears in section 1811(d), it is
24 limited to those costs that are "attributable to the proposed use." No such express limit is found
25 where section 1812 requires an agency to determine fair compensation, nor in the definition of "fair
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1 compensation" contained in section 1811(e). This, according to MWD, means that the Legislature
2 did not intend to limit the factors other than replacement costs to those attributable to the proposed
3 use. The Court does not agree. Under section 1811(d), a transferor whose wheeling transaction
4 contributes to the eventual need to replace a conveyance facility is required to pay only its fair share
5 of the cost of such replacement, but not the cost of replacing the entire system. Just so, it is required
6 to pay its fair share of the capital, operation, and maintenance costs incurred for the use of a
7 particular conveyance facility, but not for the entire system. It would be illogical for this Court to
8 conclude that the Legislature, without having explicitly stated its intent to do so, intended on the one
9 hand to limit "replacement costs" to the facilities actually used in a given transfer, while on the other
10 hand permitting every other cost element to be included system-wide.

11
12 Moreover, the phrase "reasonable charges incurred by the owner of the conveyance system,"
13 must be read to effectuate rather than frustrate the legislative purpose. Had the Legislature intended
14 an agency who owns water conveyance facilities to recover all system-wide costs through wheeling
15 rates, it would have used some other word than "incurred," to describe the compensation to which
16 the owner is entitled, and it would not have tied fair compensation to the proposed use of a water
17 conveyance facility. The stated purpose of the statute is to provide financial relief or supplemental
18 income for those who may wish to sell, lease, or exchange water, and to encourage such water
19 transfers. It is not consistent with that purpose that owners of the conveyance facility recover all of
20 their costs of being in business and doing business as a water district, regardless of whether or not
21 such costs are related to a wheeling transaction. Under the statutes in question, an owner of facilities
22 is entitled to fair compensation for the increased costs necessitated by a transferor's use of its
23 facilities and nothing more.

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1 Even if the definition of "fair compensation" could be read to permit MWD to include
2 capital, operation, and maintenance costs for all of its facilities on a system-wide basis, such a
3 reading still would not support MWD's position that it is entitled to include its contractual supply
4 payments for State Water Project water or its conservation payments. The fact that MWD treats its
5 take-or-pay entitlement to State Water Project water as a capital asset may be reasonable, but that
6 fact does not permit it to pass that cost on to members who wish to transfer non-State Water Project
7 water. These are not costs incurred in connection with a proposed use of MWD's facilities for a
8 wheeling transaction. Likewise, conservation incentive payments costs are not incurred, even in
9 part, in connection with or because of a proposed wheeling transaction.

11 MWD also points to the use, in section 1811(c), of the words "conveyance system" rather
12 than "conveyance facility" as is used in other portions of the Wheeling Statutes. According to
13 MWD, the Legislature used the word "conveyance system" in the phrase "the reasonable charges
14 incurred by the owner of the conveyance system" to reveal its intent that the costs outlined in the
15 definition of fair compensation are those for the entire conveyance system. Section 1811(c) cannot
16 be read in the way proposed by MWD. The use of the term "conveyance system" in section 1811(c)
17 describes the owner, not the charges incurred.

19 The statutory notes to section 1810 make clear that the overall purpose of the Wheeling
20 Statutes is to encourage water transfers. It is entirely consistent with that purpose that any fair
21 compensation determination be based upon the facility or facilities to be used in a proposed
22 transaction. This Court is required to give the legislation a reasonable and common sense
23 interpretation consistent with the purpose of the statute, to give significance to every word and part,
24 and to harmonize the parts by considering a particular clause or section in the context of the whole.
25 Fields v. Eu (1976) 18 Cal.3d 322, 328; Simpson v. Unemployment Ins. Comp. Appeals Bd. (1986)

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1 187 Cal.App.3d 342, 352. It therefore cannot interpret the phrase "incurred by the owner of the
2 conveyance system" as providing that MWD or any other owner of a water conveyance facility may
3 include costs for the whole of its water conveyance system. Nor can it single out the description of
4 replacement costs in section 1811(d) as "attributable to the proposed use" as an indication of
5 legislative intent to permit all other costs to be system-wide in light of the rest of the legislation.

6 The "No Injury" Provision

7
8 In support of its assertion that it may include system-wide costs, MWD points to the "no
9 injury" portion of Water Code section 1810(d). This section provides: "This use of a water
10 conveyance facility is to be made without injuring any legal user of water and without unreasonably
11 affecting fish, wildlife, or other instream beneficial uses and without unreasonably affecting the
12 overall economy or the environment of the county from which the water is being transferred."

13
14 According to MWD, as a member wheels water purchased outside of MWD, other member
15 agencies will be required to pick up the system-wide fixed costs that member has avoided unless
16 MWD can include system-wide fixed costs in the wheeling rates. MWD contends that its member
17 agencies are "legal users" of water that are to be protected from economic injury under section
18 1810(d). It argues that although other clauses of section 1810(d) are modified by the phrase "of the
19 county from which the water is being transferred," the phrase "any legal user of water" is not. Thus,
20 according to MWD, the Legislature intended in the second part of the sentence to protect the overall
21 economy and environment "of the county from which the water is being transferred," but did not so
22 limit the legal users of water it sought to protect in the first part of the sentence. The Court notes
23 that in other chapters of the Water Code, some of which pre-date the Wheeling Statutes, there are
24 references to the phrase, "legal user of water". For example, under Chapter 10.5, before the State
25 Board may grant a petition by a water rights holder to effectuate a diversion, the Board must be sure
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P.13/24

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1 that the proposed change would not "injure any legal user of the water, and would not unreasonably
2 affect fish, wildlife, or other instream beneficial uses." Water Code §1725 and §1736. See also
3 Division 1 (General State Powers over Water (§§100, et seq.)), Ch. 3.6 (Deference to Decisions of
4 Local or Regional Agencies), § 386; Division 2 (Water) Part 1, Ch. 1.5 (Water Leases), and §1702.

5 The Court finds that the Legislature intended the same meaning in the Wheeling Statutes that
6 it did elsewhere in the Water Code. It cannot reasonably interpret the phrase "legal users" to
7 encompass other member agencies not using the transferred water. The protection does not extend to
8 potential economic harm to other MWD member agencies which hold no rights to the water.
9

10 Moreover, as defendants note, it is not certain that MWD's remaining members would be
11 economically injured by one of its members engaging in a wheeling transaction. Defendants point to
12 statements by MWD's chairman and others that indicate that where excess capacity exists, wheeling
13 will provide an economic benefit to MWD and its members.
14

15 Defendants further reason that even if economic injury to remaining members were the sort
16 of injury that the Legislature sought to prevent, the question of whether the other member agencies
17 would suffer such injury would need to be determined on a case-by-case basis. This is so because
18 the existence of capacity, a requisite for any wheeling transaction, must be determined on a case-by-
19 case basis after a transferor requests the use of MWD's facilities. Thus, defendants contend that
20 MWD is mistaken in urging that the "no injury" provision supports its right to include system-wide
21 costs.
22

23 In determining the Legislature's intent, the "first step is to scrutinize the actual words of the
24 statute, giving them a plain and commonsense meaning (citations omitted)." California Teachers
25 Assn. v. Governing Bd. of Rialto Unified School Dist. (1997) 14 Cal.4th 627. Ordinary rules of
26 statutory construction support the position that the Legislature intended the "no injury" provision to
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1 protect those with water rights in the area of the water's origin. The "no injury" requirement is
2 placed in section 1810(d), along with protections for instream beneficial uses, the environment and
3 economy of the county from which the water is being transferred, rather than in the 1811(c) "fair
4 compensation" definition. It seems clear that the purpose is to ensure that the transfer of water
5 beyond the area of its origin does not cause unmitigated negative impacts on the environment or on
6 those users in the county from which the water is being taken. To construe the "no injury"
7 protection as having been included to protect MWD's other members and/or customers from
8 fluctuating prices and rates would make the compensatory framework set out in section 1811
9 unnecessary. The "no injury" provision cannot be read in such a way as to render the limitations on
10 fair compensation set out in section 1811(c) meaningless.

12 Efficient Use

13 MWD also notes that one of the stated policies of the Legislature was to "facilitate the
14 voluntary sale, lease, or exchange of water or water rights *in order to promote efficient use.*"
15 (Emphasis added.) MWD contends that encouraging transactions in which entities purchase water in
16 order to avoid paying their share of the costs of MWD's infrastructure, will not result in an efficient
17 use of the state's water.

19 Defendant CPIL correctly counters that the "efficient use" envisioned by the Legislature was
20 the transfer of water from those with excess supply to those with insufficient supply to meet their
21 needs. According to CPIL, the inefficient use that the Legislature hoped to cure was the unnecessary
22 use of water by people and entities solely for the purpose of maintaining their rights to water which
23 they do not need for their own use.

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MWD's Charge for Creation and/or Reservation of Capacity

The Non-Interruptible Service Rate

In addition to other system-wide costs such as those capital costs discussed above, MWD has included a cost for guaranteed availability of capacity in its uninterruptible rate. Such a charge for guaranteed availability is not permitted under the statutes.

Under the Wheeling Statutes MWD is only required to offer its members the use of its excess capacity *when and if such excess capacity exists*. MWD contends that its uninterruptible service at its \$262 rate goes farther than that and asserts it is entitled to charge a premium. MWD asserts that it is reserving space and ought to be entitled to recover costs of dams and reservoirs, existing and under construction. Unfortunately, the Wheeling Statutes do not permit it. Rates set under the Wheeling Statutes are for the cost of using unused capacity, not reserving or creating unused capacity.

For this reason, and those set forth above, this Court cannot validate the \$262 per acre foot "firm" wheeling rate.

The Interruptible Service Rate

There is a separate reason that the \$141 per acre foot rate for interruptible service cannot be validated under the Wheeling Statutes. The service is interruptible by MWD for "any reason." Members who wish to transfer water through MWD's facilities may choose to pay a lower rate in exchange for taking the risk that the facilities may be unavailable to them should MWD need them for any other use. However, section 1810(e) of the Water Code provides only that "[a]ny person or public agency that has a water service contract with or the right to receive water from the owner of the conveyance facility who has an emergency need may utilize the unused capacity that was made available pursuant to this section for the duration of the emergency." Thus, under the Wheeling Statutes, any wheeling transaction may be interrupted in the case of an emergency, but for no other

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1 reason. Therefore, even were it not for the fact that the \$141 rate contains some system-wide costs
2 and is set in a postage stamp fashion, this Court cannot validate that rate because the service offered
3 is less than that required by the Wheeling Statutes.

4 II. Postage Stamp Rates Set in Advance

5 As noted, MWD's Resolution 8520 set two rates - the \$262 rate for non-interruptible
6 use and the \$141 rate for interruptible use of its water transportation facilities. These rates were
7 advance rates, set to cover any transaction which might be proposed during the time period for which
8 the rates were to be in effect. Several portions of the Wheeling Statutes reveal that this postage
9 stamp approach is not what the Legislature intended.

10 Section 1812 requires the agency owning the water conveyance facility to make certain
11 determinations about each proposed wheeling transaction "in a timely manner." This means more
12 than simply "on a regular basis." The amount and availability of unused capacity, which, according
13 to section 1812(a) the owner is to determine, can only be determined *after* a lease of excess space is
14 requested by a water transferor. Subsection (e) of section 1811 provides: "Unused capacity" means
15 space that is available within the operational limits of the conveyance system and which the owner is
16 not using during the period for which the transfer is proposed and which space is sufficient to convey
17 the quantity of water proposed to be transferred." Since one cannot calculate unused capacity except
18 in light of each proposed transfer, the Legislature must have intended that the owner make its
19 determination of capacity *after* having received a proposal for a particular transaction.

20 Furthermore, this is the only interpretation consistent with the Court's conclusion that any
21 determination of fair compensation must be made with respect to a particular proposed use and not
22 simply in the abstract. Thus, MWD may not set "postage stamp" rates in advance without regard to
23 any particular wheeling transaction.

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CONCLUSION

Under the Wheeling Statutes, "fair compensation" is limited to costs attributable to the actual facilities to be used in a particular proposed water transfer, and the "fair compensation" determination cannot be made ahead of time and without reference to a particular proposed transaction. MWD's inclusion of system-wide costs and its setting of rates before receiving a request for use of its facilities, are incompatible with the Wheeling Statutes.

For all of the foregoing reasons, this Court cannot validate either of MWD's wheeling rates. Inasmuch as the rates as currently set were not arrived upon by means permitted by the Wheeling Statutes, there is no need for further proceedings concerning the dollar amounts of the rates. The Court's rulings on the parties' requests for judicial notice and evidentiary objections are attached hereto. Defendants are to prepare a form of judgment consistent with the findings herein.

Pursuant to California Rules of Court, rule 232, this Tentative Decision shall be the Statement of Decision, unless, within fifteen days of the date hereof, the Court shall receive specified controverted issues or proposals regarding Phase I issues not covered herein.

DATED:

January 12, 1998
Laurence D. Kay
Judge of the Superior Court